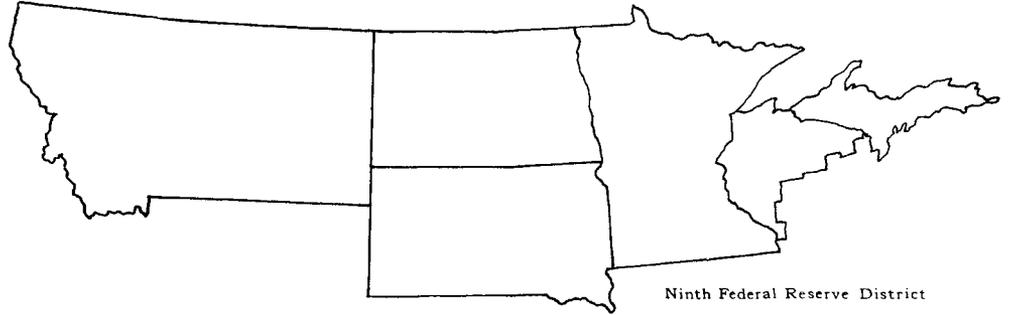


# FEDERAL RESERVE BANK OF MINNEAPOLIS

## press information



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### GALUSHA ANSWERS FED CRITICS

"Of late, the Federal Reserve has come in for a good deal of criticism -- more than its share," said Hugh D. Galusha, Jr., President of the Federal Reserve Bank of Minneapolis, in a speech delivered at the Mid-Winter Conference of the Savings League of Minnesota, February 12, in St. Paul. "I am not complaining. Whatever it does, the Federal Reserve must expect criticism. Also, criticism, however mistaken, is reassuring. No one bothers to criticize an institution which can do nothing, whether for good or bad."

Galusha addressed himself to critics who have suggested that the System has not prevented inflation. "It is ironic that the System should now be charged with having become indifferent to inflation. For a long time, the charge was that it worried only about price stability, and not at all about employment. But it is easily demonstrated that the Federal Reserve has not become indifferent to inflation." Galusha then cited the experience of 1965 when the System increased discount rates over the protests of the administration in Washington. Inflation control was the Fed's objective. "But the Federal Reserve is not all-powerful," continued Galusha; "it cannot, by itself, ensure stable prices, or curb inflationary pressures."

"Perhaps the most important explanation for the limited effectiveness of monetary policy is that the System, unlike its critics, cannot be single-minded about

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inflation." Galusha recalled the experience of early 1966 when the Federal Reserve had to resist the temptation to drastically curb the growth of the money supply. Because, he said, "this would have meant still higher interest rates, and very likely the failure of a few thrift institutions, which could easily have seriously undermined confidence in the entire U.S. financial system."

But he admitted that the System had erred in holding to a less restrictive monetary policy than was required in the second half of 1968. "System officials, along with nearly everyone else, were wrong in expecting fiscal restraint to take effect quickly. They perhaps underestimated the strength of inflationary pressures, or just how anxious the public, conscious of rising prices, was to spend on goods and services. And having been overly optimistic in its estimate of when fiscal restraint would take hold, it delayed too long before imposing further monetary restraint." Further restraint was subsequently imposed by the Fed, but gradually, explained Galusha, with the objective of curbing inflation without a recession and the attending sharp rise in unemployment.

Galusha then turned to critics who suggest that the Fed does not pay attention to the money supply in formulating its decisions. He pointed out how the New York Fed conducting open market operations is routinely told to "...modify its open market operations, depending on how rapidly the money supply, broadly defined, appears to be increasing. Clearly, then, it cannot truthfully be said that the Federal Reserve pays no attention to the money supply."

The Fed President indicated that the System cannot pay attention only to the money supply, as some critics suggest. A steady rate of growth of the money supply may imply an average level of interest rates inconsistent with the U.S. balance of payments objective. "Imagine U.S. short-term rates averaging three or four percent; the U.S. might not be able to stand the implied loss of funds to other countries, or the implied balance of payments deficit."

"Anyone who defends an institution against its critics runs a risk; he may

give the impression that the institution he defends is, in his judgment, perfect. I do not believe the Federal Reserve is perfect. But if the Federal Reserve is not perfect, neither is it as misguided as some of its critics would have you believe. Would that the Federal Reserve's critics were as willing to learn as, through its history, it has been."